IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No. .

J. STERLING ROCKEFELLER,
Petitioner,

vs.

JOSEPH D. NUNAN, Commissioner of Internal Revenue for the Second District of New York,
Respondent.

BRIEF IN SUPPORT OF PETITION.

Opinions Below.

The opinion of the Tax Court of the United States has been reported only in memorandum form but is set forth in full in the transcript (R. 36 to 37). The opinion of the United States Circuit Court of Appeals for the Second Circuit has been reported officially in 142 Federal Reporter 2d Series pages 354 to 356 and is set forth in full in the transcript (R. 185 to 188).

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925. The case arises under an internal revenue law.

Statement of the Case.

For a statement of the case reference is made to the summary statement contained in the petition for writ of certiorari filed herein on pages 2 to 5.

Specification of Errors.

The Circuit Court of Appeals for the Second Circuit in its decision herein erred:

1. In refusing to determine that the petitioner ascertained as worthless during the calendar year 1937 the $78,000 face amount of Garrison Fire Detecting System, Inc. Secured Debenture Bonds which cost the petitioner $76,900, and in refusing to allow as a deduction from petitioner's gross income for the year 1937 said sum of $76,900 as a bad debt ascertained and charged off the petitioner's books as such in 1937.

2. In determining that the petitioner did not prove that the hope which petitioner entertained throughout 1936 of some salvage from his investment in the Secured Debentures was extinguished in 1937, in view of the petitioner's uncontradicted testimony that as a result of the sale of the patent interests by the Trustee at a price which did not permit any payment to the bondholders, the petitioner determined his debentures were worthless and valueless (R. 53).

3. In determining that all the Tax Court decided was that petitioner had not proved that he "ascertained" the Secured Debentures to have become "worthless" in 1937, in view of the Tax Court's statement that the Commissioner had determined, in effect, that the petitioner had ascertained such worthlessness in 1936 (R. 37) although the Commissioner had never, according to the proof, made such a determination (R. 11).

4. In determining that the petitioner reported his gross income for 1936 at $103,477.89 against which he claimed deductions aggregating $53,322.02 for the reason that the Circuit Court has stated that no year other than 1937 has any bearing in the matter and accordingly petitioner's individual income tax return for the calendar year 1936 was inadmissible, irrelevant and immaterial just as much as his similar return for any year other than 1937 would have been and that no charge or finding had been made of anything but good faith on petitioner's part.

5. In failing to admit in evidence the 1937 individual federal income tax return of Earl H. Johnson and the offer of testimony in connection therewith.

6. In finding a deficiency of $32,733.96 for the year 1937 in lieu of the determination that there is no income tax due from petitioner for the year in controversy.

ARGUMENT.

POINT I.

The petitioner ascertained during the calendar year 1937 that his Secured Debentures were worthless and in 1937 charged off the cost thereof to him.

The evidence is uncontradicted that the petitioner decided in 1937 as a result of the Bankruptcy sale in that year that the Secured Debentures were worthless and that the petitioner's accountant in 1937, at the direction of the petitioner, made the proper entry charging off and showing the worthlessness in 1937 of the Secured Debentures owned by the petitioner to the extent of an original entry of $77,000 reduced by stipulation to $76,900. (Record 29, 53, 60 to 62, 80).

In the case of *Rosenthal* v. *Commissioner*, 124 Fed. 2d, 474, 476 (C. C. A. 2d), the use of the subjective test in

determining ascertainment of worthlessness was stated in the following language:

> "In *Curry* v. *Commissioner*, 2 Cir., 117 F. 2d 307, 309, 310, we held, however, that the 'subjective test' as we called it, was the right one; that is, that the proper year was that in which the taxpayer did 'ascertain' the fact, no matter how much earlier a reasonably prudent person would have done so. *Moore* v. *Commissioner*, 2 Cir., 101 F. 2d 704, and *Jones* v. *Commissioner*, 7 Cir., 38 F. 2d 550, suggests the same doctrine, though they can scarcely be said to decide it; *Sabath* v. *Commissioner*, 7 Cir., 100 F. 2d 569, is the other way. The cases are not in accord, but with deference we can find no ground for importing any 'objective test' into the section. The language does not intimate anything of the sort, the contrast with §23 (e) and (f) suggests the opposite, and there is no disclosed or probable purpose which the natural meaning of the words will thwart. If it be objected that the 'subjective test' offers opportunity for evasion, we answer, first, that the taxpayer has the burden of proving a negative—i. e., he must show that he did not 'ascertain' the debt to have been 'worthless' before the year in question—second, that the fact that a prudent person would have 'ascertained' that fact earlier is always evidence that the taxpayer did so himself, and third, that if these two considerations do not adequately protect the Treasury, the responsibility for its better protection rests with Congress. We hold therefore that a taxpayer is not charged with the duty of 'ascertaining' the 'worthlessness' of a 'bad debt' at any time before he actually does so."

The Tax Court in its opinion in the instant cause had gone much further than was necessary under the principle of subjective test set forth above and had stated that it was the petitioner's burden to show erroneous the Commissioner's determination, in effect, that petitioner did so ascertain the worthlessness in 1936, and the Tax Court further reached the conclusion that the Secured Debentures were in fact worthless in 1936.

The Circuit Court recedes from the dilemma created by the decision of the Tax Court by ruling in effect that the

petitioner really did not ascertain the Secured Debentures to be worthless in 1936 and by his uncontradicted testimony as well as by evidence that he loaned money in 1936 to one of the licensees of the Delaware corporation, showed that he still retained at the end of 1936 hope that something might be realized from the sale of the patent interests which were the security for the Debentures. (See *Helvering* v. *Hammel*, 311 U. S. 504).

Using this face-about, the Circuit Court then strives for the conclusion that, because the patent interests were sold in 1937 for $100 subject, however, to the lien of the Secured Debentures, the petitioner's position is less plausible and that while the remnant of value may or may not have continued throughout 1937, there is no way to tell whether it did or not.

The above conclusion is in the face of the uncontradicted testimony of petitioner that, upon the sale by the Trustee in Bankruptcy of the patent interests, the taxpayer lost all hope of ever receiving anything on his Secured Debentures.

The petitioner after his experience of years in investing funds in the Delaware corporation and its licensees refused to put in any more money but allowed the patent interests to be sold. This very act, it is respectfully submitted, is further positive evidence of his ascertainment in 1937 of the worthlessness of the Secured Debentures.

The similarity is striking between the testimony of the petitioner herein and of the petitioner in the *Rosenthal* case, *supra*, after reference back to the then Board of Tax Appeals (not reported officially, Docket 99950, February 7, 1942). The general tenor of Rosenthal's testimony was that he did not ascertain the debt in question to have been worthless prior to 1936 but did so ascertain it as worthless in that year. He stated that he did not have any doubt in the years prior to 1936 that he would ultimately collect all or at least a substantial part of this indebtedness.

The Member also rendered the following opinion:

> "It goes without saying that this portion of the record furnishes, if believed, the most direct ap-

> proach to petitioner's state of mind, the question described in *Rosenthal* v. *Commissioner* as 'the only relevant fact.' While there is other testimony tending to qualify this statement or detract from its reliability, we are not willing to characterize it as deliberately false, as would be necessary were we to come to the contrary conclusion. * * *'''

There is no claim of lack of good faith on the part of the petitioner nor is there any other testimony tending to qualify or detract from the petitioner's uncontradicted testimony as to his ascertainment in 1937 of the worthlessness of the Secured Debentures. By the same token the 1936 federal individual income tax return of the petitioner is clearly irrelevant for the reasons already stated in Assignment of Error No. 4.

The findings of the Tax Court disclose the entire transaction and pertinent facts found in connection therewith are accordingly reviewable by the Circuit Court of Appeals and the decision of the Circuit Court on such points is reviewable in this Honorable Court. *Helvering* v. *Price*, 309 U. S. 409, 412.

The Circuit Court of Appeals for the Second Circuit admits that the cases are not in accord in the various Circuits but has, up until the instant cause, affirmed its belief in the principle which is enunciated in the Rosenthal decision. (*Mayer Tank Mfg. Co.* v. *Commissioner*, 136 Fed. 2d 588 (C. C. A. 2d); *Harris* v. *Commissioner*, 140 Fed. 2d 809 (C. C. A. 2nd, decided February 9, 1944). See also *San Joaquin Brick Co.* v. *Commissioner*, 130 Fed. 2d, 220 (C. C. A. 9th); *Matter of Huitt* v. *Mealey*, 292 N. Y. 52).

In view of the apparent conflict among the decisions of the various Circuit Courts of Appeals, and as this principle appears to be one which this Honorable Court has not passed on, so far as we have been able to ascertain, it is respectfully requested that the decision of the Circuit Court of Appeals in the instant case should be reviewed by this Honorable Court.

POINT II.

The Circuit Court of Appeals erred in upholding the refusal of the Tax Court to admit in evidence a certain statement attached to the 1937 Federal Income Tax Return of Earl H. Johnson, an owner of similar Secured Debenture Bonds, and the offer of testimony in connection therewith.

At the trial of this cause in the then Board of Tax Appeals, there was offered in evidence on behalf of the taxpayer a schedule attached to the individual federal income tax return for the taxable year 1937 of Earl H. Johnson, who was the holder of $10,000 of Secured Debenture Bonds of the Delaware corporation of the same series as those owned by the petitioner (R. 65). The exhibits and testimony offered would have shown that Earl H. Johnson claimed to have ascertained his Bonds to be worthless in the taxable year 1937 and had charged them off within that taxable year, and that after a review by the Technical Staff, the Commissioner of Internal Revenue, respondent herein, allowed Johnson's deduction in the year 1937 of the cost to Johnson of said Bonds. The information contained in the schedule attached to his tax return (R. 66) shows that all the substantial facts were before the Commissioner and that the Commissioner's decision thereon is highly important to demonstrate that the Commissioner had previously examined the matter and had found that the calendar year 1937 was the year in which the Debentures were reasonably ascertained to have become worthless.

It is respectfully submitted that the offer of the above testimony and evidence was relevant and material on the grounds above stated and that it was error to refuse this offer at the trial. Furthermore, it appears to be a case of first impression as this question has not, in so far as we have been able to find, been settled by this Court.

Respectfully submitted,

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